



Spirit
CORPORATION

1994 ANNUAL REPORT

Energy Plus

CORPORATE PROFILE

Spirit Corporation is a Canadian oil and gas company involved in the acquisition of, exploration for, and development and production of petroleum and natural gas reserves in Western Canada. The Corporation's core properties are located in the Cecil and Rainbow areas of Alberta and in Loverna, Saskatchewan. There are currently 17,638,116 common shares issued and outstanding. The Corporation's common shares are listed for trading on The Alberta Stock Exchange (symbol "SRP").

NOTICE OF ANNUAL MEETING

The Annual General Meeting of Shareholders will be held on Wednesday, June 14, 1995 at 11:00 a.m., at the Calgary Petroleum Club, Cadium Rooms A & B, 319 - 5th Avenue S.W. Calgary, Alberta.

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Glossary of Terms

BBLS	barrels
BOPD	barrels of oil per day
BOE	barrel of oil equivalent
MBBLS	thousands of barrels
MCF	thousand cubic feet
MCF/D	thousand cubic feet per day
MMCF	million cubic feet
MMCF/D	million cubic feet per day

REPORT TO SHAREHOLDERS

Spirit Corporation exited 1994 with a solid foundation from which to grow. By December 31, 1994 the Corporation was free of debt and averaging 450 barrels of oil equivalent (BOE) per day.

However, 1994 was not without difficulties. From March to November 1994, the Corporation laboured under a lawsuit. Although the suit was settled by negotiation, during this period Spirit was unattractive to bankers, investors and partners alike. The negotiated settlement required the Corporation to issue 918,550 common shares and revise the terms of an existing share purchase warrant. This paved the way for renewed operating activity to establish Spirit Corporation as a credible oil and gas company in the eyes of our shareholders and the business community.

With the resolution of the lawsuit, a concentrated effort was exerted to develop oil and gas opportunities in the realms of: exploitation of by-passed reserves, exploration in lower risk multi-zone areas, and acquisition targets. Bolstered by a dedicated technical staff and a supporting network of consultants, Spirit has generated an inventory of high quality exploitation and exploration prospects to be pursued in the upcoming year. The December recompletion of a well on the Rainbow South property became the first taste of success for the Corporation in these endeavours. With full cycle finding and on stream costs of \$0.71 per barrel, the 252,700 barrels of oil added by this pool is seen as an example of the value which can be derived from this type of project.

Management is optimistic about the positioning of the Corporation relative to the opportunities to be exploited in 1995. Continued success from existing exploitation and exploration projects will yield valuable oil and gas reserves. Opportunities will arise from these projects that will allow the Corporation to develop new reserves, increase daily production and bolster cash flow that will result in a stronger company with clear added value to its shareholders.

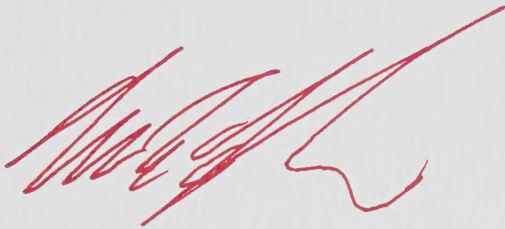
Highlights of 1994

- Resolved lawsuit leaving the Corporation debt free and positioned for growth.
- Added 252,700 barrels of reserves at Rainbow South resulting in an increase of daily production of 60 BOPD at a net cost of \$0.71 cents per barrel.
- Replaced 168% of the Corporation's 1994 production.
- Acquired an inventory of 5,280 gross acres of high quality exploratory acreage. The disposition of several of Spirit's non-core assets (concluded in the first quarter of 1995) has had minimal effect on production and positions the Corporation to accelerate its growth in its core areas.
- Sold approximately 1/3 of the Corporation's interest in the Cecil property. The proceeds paid the Corporation's share of the Cecil gas conservation project and retired all bank debt.

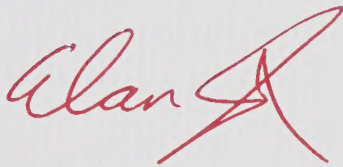
Outlook and Growth Strategy

Spirit Corporation is well positioned from a staffing, industry network, and financial point of view for maximizing oil and gas business activities. By refocusing its efforts in multi-zone, high quality areas of the Western Canadian Sedimentary Basin and shedding itself of non-core assets, the Corporation has been streamlined to accelerate its plans for growth. Low cost, medium risk prospects in both the exploration and exploitation arenas have been identified and secured for evaluation over the 1995 fiscal year. Growth opportunities via the merger and acquisition route will become attractive. Spirit believes the softening of the oil and gas markets has created a situation for well managed, aggressive juniors to accelerate their growth over the next few months. By applying these strategies, the Corporation is committed to identifying superior growth opportunities and maximizing shareholder value.

On behalf of the Board of Directors and Officers



Michael E. Lobsinger
Chief Executive Officer



Alan D. Jack, P.Eng.
Chief Operating Officer

Operations

LAND

During 1994, Spirit was successful in establishing landholdings in new exploration areas, bringing total gross undeveloped land holdings to 21,305 acres (9,682 net) as of December 31, 1994.

The Corporation plans to continue strengthening its land position throughout 1995.

Land Holdings at December 31, 1994 (acres)

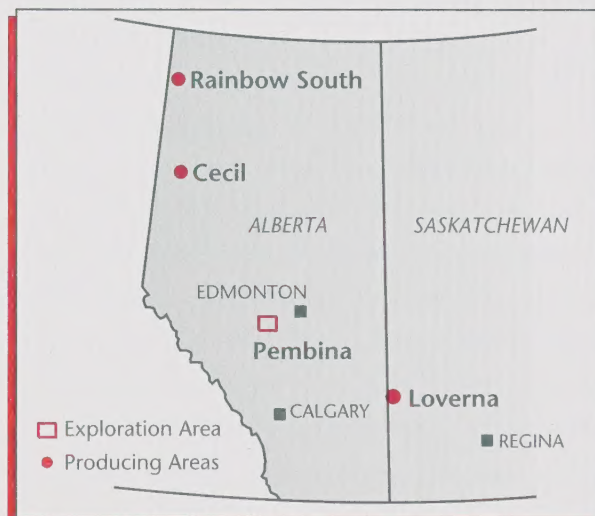
	<u>Undeveloped</u>		<u>Developed</u>	
	Gross	Net	Gross	Net
Alberta	20,467	9,457	19,089	7,709
Saskatchewan	838	225	3,842	1,423
TOTAL	21,305	9,682	22,931	9,132

EXPLORATION

With renewed enthusiasm, Spirit Corporation embarked upon a path to accelerate its growth during the fall of 1994. Assembling technical expertise and streamlining the Corporation by divesting non-core properties, Spirit has identified several high quality prospects in areas of the Western Canadian Sedimentary Basin that it believes are profitable focus areas. In conjunction with industry partners, Spirit has secured an interest in 5,280 gross acres (848 net) in its exploration area of Pembina. Preliminary

evaluations have shown promise for both oil and gas production in this multi-zone, year round accessible area. The Corporation is favourably positioned to evaluate the identified oil and gas prospects in this area and plans to continue to assemble an acreage position over new, internally generated prospects next year.

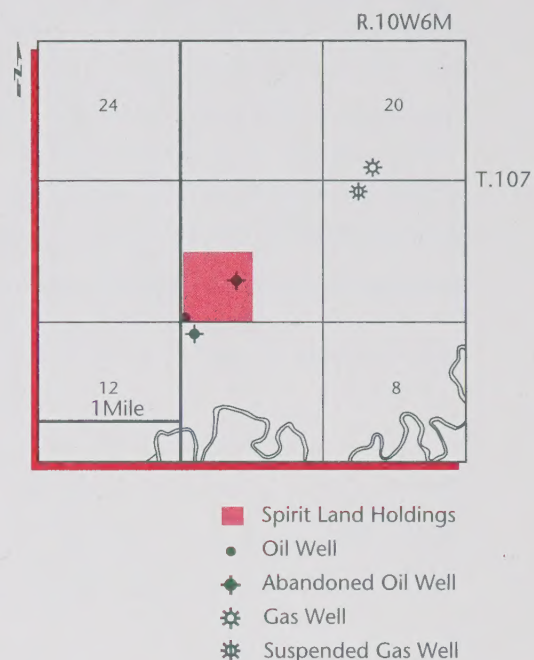
Areas of Operation



DEVELOPMENT

Rainbow South, Alberta

The Rainbow South property is located in the extreme northwest corner of the Province of Alberta. This 160 acre parcel, acquired by Spirit in the fall of 1994, was identified as having recompletion potential in one of the existing wells. Spirit has a 100% working interest and is operator of this property. The well was recompleted in December of 1994, and yielded water free production of 60 BOPD. The Corporation does not plan any further drilling on this property. This successful operation, combined with a 3-D seismic survey to define the pool boundary, was able to prove up reserve additions of 252,700 barrels. The finding and on stream cost of approximately \$0.71 per barrel of oil for this project makes it a valuable addition to Spirit's assets.



PRODUCTION

Cecil, Alberta

The Corporation has a non-operated interest in 16 wells in this property. These wells produce from the Triassic aged Charlie Lake member of the Schooler Creek Group. In addition to the oil revenue, the Corporation derives revenue from third party processing at the on-site facilities. During 1994, Spirit sold approximately one-third of its interest in this pool to finance its participation in a gas conservation project for this property. Geological and engineering evaluations of this pool are under way, to determine the feasibility of increasing production and adding incremental reserve additions via horizontal drilling.

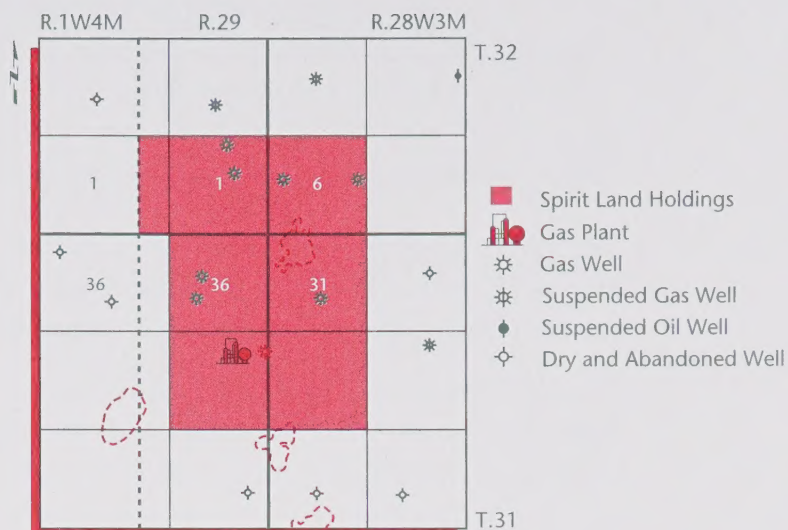


Production:	Gross	Net
OIL (BOPD)	591	164
GAS (MCF/D)	433	103

Loverna, Saskatchewan

The Corporation has a non-operated interest in 8 wells, of which 2 are producing. The wells produce gas from the Mississippian aged Bakken member of the Three Forks Formation and the Cretaceous aged Colony member of the Mannville Formation. Spirit has a working interest in the associated gathering system and gas plant.

Production:	Gross	Net
GAS (MMCF/D)	4.4	2.0



PETROLEUM RESERVES

The volumes and present value of Spirit's petroleum reserves have been evaluated as at December 31, 1994 by Sproule Associates Limited. The following tables summarize the evaluation using escalated prices. The volumes represent the Corporation's gross interest in reserves before royalties.

Reserve Volumes

	Oil (MMBLS)	Natural Gas (MMCF)	NGL's (MMBLS)
Proven Developed Producing	342.9	2846	3.2
Proven Undeveloped	—	1039	3.3
Total Proven	342.9	3885	6.5
Probable Additional	51.2	—	—
Total Proven Plus Probable	394.1	3885	6.5

Present Worth Values (\$000's)

	0%	10%	15%	20%
Proven Developed Producing	8,851	6,237	5,459	4,874
Proven Undeveloped	813	586	506	442
Total Proven	9,664	6,823	5,965	5,316
Total Probable	600	212	142	100
Total Proven Plus Probable	10,264	7,035	6,107	5,416
Alberta Royalty Tax Credit	320	262	241	223
Processing Income	1,147	768	656	573
Total	11,731	8,065	7,004	6,212

(Probable values reduced by 50% to account for associated risk).

Management's Discussion and Analysis

1994 FINANCIAL HIGHLIGHTS

Spirit's second year of oil and gas operations resulted in increases in reserves, production, and revenues, with cash flow from operations greatly improved and the loss significantly reduced. Cash flow from operations was \$872,374 or \$0.05 per share compared to \$85,274 or \$0.01 per share for 1993.

During 1993 the Corporation changed its year end from May 31 to December 31, and accordingly Spirit's 1993 consolidated statements of operations and changes in financial position reflect the seven month period ended December 31, 1993.

Petroleum & Natural Gas (\$)

	1994	1993
Revenues-net of royalties	2,370,497	1,246,707
Cash flow from operations	872,374	85,274
Per Share	0.05	0.01
Net Loss	1,760,311	3,425,311
Per Share	0.11	0.25

RESULTS OF OPERATIONS AND FINANCIAL ANALYSIS

Oil and Gas Sales, Net of Royalties (\$)

	1994	1993
Oil and gas sales	2,786,535	1,360,845
Royalties, net of royalty income	(480,776)	(114,138)
Alberta Royalty Tax Credit	64,738	—
Oil and gas sales, net of royalties	2,370,497	1,246,707

Overall production revenue for 1994 was \$2,786,535 representing a 105% increase over 1993 revenue of \$1,360,845. Oil revenues for 1994 were \$1,052,325 versus \$721,667 for 1993. Oil production volumes increased 46 per cent from 1993 and the average price of oil decreased marginally to \$15.73 per barrel from \$15.80 per barrel in 1993.

Natural gas revenues for 1994 were \$1,734,210 versus \$639,178 for 1993. Gas production volumes increased 122 per cent from 1993 and the average price for gas increased by 22 per cent to \$1.99 per MCF versus \$1.63 per MCF for 1993.

Royalties, net of the Alberta Royalty Tax Credit were \$2.70 per BOE in 1994 versus \$1.34 per BOE in 1993. The 1993 royalty rate of 8 per cent of production is unusually low, as royalty income for 1993 offset a significant portion of the Crown royalties paid. The 1994 royalty rate of 15 per cent represents a more realistic average rate, taking into account that the Corporation continues to earn royalty income.

Processing, Transmission, Disposal Fees and Other Revenue

The Corporation earns fees from gas processing and battery operation as well from a water and waste disposal well. In addition, the Corporation has a revenue sharing agreement on a gas processing facility. Total income pursuant to the revenue sharing agreement for 1994 was approximately \$327,000. The revenue sharing agreement expires at the end of 1995 and it is expected that income from this source will drop significantly during 1995.

EXPENSES

Production Expenses

Operating costs increased relatively proportionate to the increase in production for the year. On a BOE basis, operating expenses were \$6.87 for 1994 compared to \$6.57 in 1993. During the latter part of 1994 and subsequent to the year end, the Corporation disposed of several of its non-core properties which had higher than average operating costs. As a result of the dispositions, it is anticipated that production expenses on a BOE basis will decline in 1995.

General and Administrative Expenses

General and administrative expenses increased from \$669,843 in 1993 to \$896,856 in 1994. However, taking into account that 1993 was only a seven month period, these expenses have decreased by approximately 22 per cent on an annualized basis. On a BOE basis, general and administrative expenses were \$5.83 for 1994, a 26 per cent reduction from \$7.89 per BOE for 1993. The Corporation did not capitalize any general and administrative expenses during 1994 or 1993.

Depletion and Depreciation

Depletion is calculated based on full cost accounting guidelines which require proved reserves used in the calculation are to be based on constant dollar reserve evaluations using current price and cost assumptions. Under the Canadian Institute of Chartered Accountants full cost accounting guidelines, the Corporation reduced the carrying value of its oil and gas properties by \$770,000 during 1994 and \$3,011,000 during 1993. This charge was added to the depletion and depreciation provisions. Depletion and depreciation, excluding the ceiling test write-downs, was \$10.61 per BOE for 1994 versus \$12.45 per BOE for 1993.

Settlement Costs

During the year, a statement of claim was filed against the Corporation by the Agent and the purchasers of the 4,000,000 Special Warrants which were issued in late 1993. The Agent and the purchasers sought damages of \$4,000,000 plus costs for alleged misrepresentation in the sale to them of the Special Warrants. Although the Corporation considered these allegations to be absolutely without merit, the Corporation realized that prolonged litigation, regardless of the outcome, would be to the detriment of all shareholders. Accordingly, the Corporation agreed to settle this matter out of court. The settlement included the issuance of 918,550 additional common shares at an assigned value of \$0.25 per share or \$229,638 (being approximately 6% of the amount claimed) and the amendment of the terms of the existing 2,000,000 Regular Warrants. Legal fees of \$50,554 were also incurred in the settlement. Settlement costs and legal fees have been separately disclosed as settlement costs of \$280,182 in the accompanying Consolidated Statements of Operations and Deficit.

Income Taxes

As a result of the utilization of prior years' losses, no income tax provision was necessary for 1994 or 1993.

Capital Expenditures

Capital expenditures for 1994 were \$1,710,174 a 70 per cent increase from expenditures of \$1,005,645 during 1993. To avoid oil production penalties as a result of flaring associated natural gas at the Corporation's Cecil property, a gas plant and gathering system was built during the year. As a result of the poor equity markets and especially the previously described unsettled litigation during the year, the Corporation did not attempt to raise any substantial additional equity capital during 1994. In order to fund its proportionate share of the Cecil gas plant and gathering system, the Corporation sold a portion of its interest in the Cecil property. This, along with proceeds from the disposal of non-core properties, generated funds of \$1,670,954 which were used to partially finance the 1994 capital expenditure program and to retire debt.

FINANCIAL RESOURCES AND LIQUIDITY

Working Capital

At December 31, 1994, Spirit had working capital of \$386,571 and no bank debt compared to a working capital deficiency of \$45,983, plus long term bank debt of \$500,000 at December 31, 1993. The working capital increase of \$432,554 during 1994 consisted of cash flow from operations before changes in non-cash working capital items of \$872,374, plus the issuance of share capital for proceeds of \$99,400, less capital expenditures net of dispositions of \$39,220, less long term debt repayments of \$500,000.

CAPITAL REQUIREMENTS

Spirit intends to fund its capital requirements through a combination of internally generated cash flow, bank financing and appropriately timed equity issues. The Corporation presently has an interim \$500,000 undrawn line of credit, which will most likely be enhanced as new production is either acquired or drilled.

ASSET VALUE

Reserves – proven and 50% probable (discounted at 15%)	\$ 7,004,000
Undeveloped Acreage (at estimated value)	228,000
Working Capital	386,571
Net Asset Value	\$ 7,618,571
Common Shares Outstanding	17,638,116
Net Asset Value Per Share	\$ 0.43

OUTLOOK

Results for 1995 are dependent on commodity prices, the U.S./Canadian exchange rate, the impact of current exploration related activities, acquisitions, as well as ongoing operations. Although the price of natural gas has decreased sharply in recent months, the majority of Spirit's gas is under contract which expires on November 1, 1995, at prices which were negotiated in a stronger market. The price of oil has recovered considerably during 1995 and should more than offset any gas price declines during 1995.

Auditors' Report

To the Shareholders of Spirit Corporation

We have audited the consolidated balance sheets of Spirit Corporation as at December 31, 1994 and 1993 and the consolidated statements of operations and deficit and changes in financial position for the year ended December 31, 1994 and the seven months ended December 31, 1993. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1994 and 1993 and the results of its operations and the changes in its financial position for the year ended December 31, 1994 and the seven months ended December 31, 1993 in accordance with generally accepted accounting principles.

KPMG Peat Marwick Thorne

KPMG Peat Marwick Thorne
Chartered Accountants

Calgary, Canada
April 24, 1995

Consolidated Balance Sheets

	December 31, 1994	December 31, 1993
ASSETS		
Current assets:		
Cash	\$ 97,552	\$ 1,575,710
Accounts receivable	1,019,496	1,100,771
	1,117,048	2,676,481
Property and equipment (note 3)	6,429,247	8,744,611
	\$ 7,546,295	\$ 11,421,092

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:		
Accounts payable and accrued liabilities	\$ 730,477	\$ 1,814,464
Bank debt (note 4)	—	908,000
	730,477	2,722,464
Bank debt (note 4)	—	500,000
Provision for future site restoration	228,963	180,500
Shareholders' equity:		
Share capital (note 5)	12,117,795	5,421,969
Special Warrants (note 5)	—	6,366,788
Deficit	(5,530,940)	(3,770,629)
	6,586,855	8,018,128
	\$ 7,546,295	\$ 11,421,092

See accompanying notes to consolidated financial statements.

On behalf of the Board:



Michael E. Lobsinger
Director



Thomas D. Wood
Director

Consolidated Statements of Operations and Deficit

	Year ended December 31, 1994	Seven months ended December 31, 1993
Revenues:		
Oil and gas sales, net of royalties	\$ 2,370,497	\$ 1,246,707
Processing, transmission, disposal fees and other	536,318	79,649
Interest and other income	24,772	12,702
	2,931,587	1,339,058
Expenses:		
Production	1,057,866	558,155
General and administrative	896,856	669,843
Depletion and Depreciation	2,403,047	4,068,585
Settlement costs (note 5(d))	280,182	—
Interest on long-term bank debt	53,947	25,786
	4,691,898	5,322,369
Other item:		
Gain on settlement of contingency (note 5(e))	—	558,000
Net loss for the period	1,760,311	3,425,311
Deficit, beginning of period	3,770,629	7,014,917
Applied as a reduction against the stated value of common share capital (note 5(a))	—	(7,014,917)
Loss upon cancellation of common shares recovered (note 5(e))	—	345,318
Deficit, end of period	\$ 5,530,940	\$ 3,770,629
Net loss per share	\$ 0.11	\$ 0.25

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Financial Position

	Year ended December 31, 1994	Seven months ended December 31, 1993
Cash provided by (used in):		
Operations:		
Net loss for the period	\$ (1,760,311)	\$ (3,425,311)
Add (deduct) items not requiring a cash outlay:		
Depletion and depreciation	2,403,047	4,068,585
Settlement costs (note 5(d))	229,638	—
Gain on settlement of contingency	—	(558,000)
Cash flow from operations	872,374	85,274
Net change in non-cash working capital items relating to operations	(1,002,712)	516,046
	(130,338)	601,320
Financing:		
Issue of common shares for cash, net of related expenses	99,400	85,400
Issue of common shares to acquire property and equipment	—	35,000
Issue of common shares to acquire subsidiary companies	—	4,599,000
Increase (reduction) in bank debt	(1,408,000)	638,000
Issue of Special Warrants, net of related costs of \$633,212	—	6,366,788
	(1,308,600)	11,724,188
Investments:		
Additions to property and equipment	(1,710,174)	(1,005,645)
Proceeds from sale of property and equipment	1,670,954	—
Recovery of 1,500,000 common shares for cancellation (note 5(e))	—	(638,000)
Acquisition of subsidiaries, net of cash assumed of \$nil	—	(9,496,327)
	(39,220)	(11,139,972)
Increase (decrease) in cash during the period	(1,478,158)	1,185,536
Cash, beginning of period	1,575,710	390,174
Cash, end of period	\$ 97,552	\$ 1,575,710
Cash flow from operations per share	\$ 0.05	\$ 0.01

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Year ended December 31, 1994 and seven months ended December 31, 1993

1. SIGNIFICANT ACCOUNTING POLICIES:

(a) Principles of consolidation:

The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries: Spirit Energy Corp., Leduc East Petroleums Inc., 554742 Alberta Ltd., and Spirit Waste Management Inc. Effective April 1, 1994, the assets and liabilities of 567637 Alberta Ltd. and H.R.P. Holdings Ltd. were wound up into the Corporation.

(b) Petroleum and natural gas operations:

The Corporation follows the "full cost" method of accounting for petroleum and natural gas operations whereby all costs of exploring for and developing petroleum and natural gas reserves are capitalized into a single Canadian cost centre. Such costs include land acquisition costs, geological and geophysical costs, carrying charges on non-producing properties, costs of drilling both productive and non-productive wells and overhead charges directly related to acquisition, exploration and development activities.

All capitalized costs, including the costs of production equipment, are depleted and depreciated on the unit-of-production method based on estimated gross proven reserves determined by the Corporation and independent engineers. For purposes of the calculation, natural gas reserves and production are converted to equivalent volumes of petroleum based upon relative sales value basis.

Costs of acquiring unproven properties are initially excluded from the full cost pool. These unevaluated properties are assessed periodically to ascertain whether impairment has occurred. When proven reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion.

In applying the full cost method, the total capitalized costs less accumulated depletion, depreciation, deferred income taxes and provision for future site restorations are limited to an amount equal to the estimated future net revenue from proven reserves (based on prices and costs at the balance sheet date) plus the cost (net of impairments) of unproved properties less the estimated cost of future site restorations, general and administrative expenses, financing costs and income taxes ("cost ceiling"). Where the cost ceiling is less than the capitalized cost and the deficiency is related to significant acquisitions made within the prior twenty-four month period, and the deficiency is not considered permanent, a write-down of petroleum and natural gas properties is not required.

Proceeds from the sale of petroleum and natural gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale would significantly alter the rate of depletion and depreciation.

Substantially all of the Corporation's exploration and development activities related to petroleum and natural gas are conducted jointly with others. The accounts reflect only the Corporation's proportionate interest in such activities.

(c) Future site restoration costs:

Future site restoration costs are amortized using the unit-of-production method based on estimated gross proven reserves. Costs are estimated by the Corporation based on current regulations, costs, technology and industry standards. Removal and site restoration expenditures are charged to the accumulated provision as incurred.

2. BUSINESS COMBINATIONS:

On September 16, 1993, the Corporation acquired petroleum and natural gas assets in the Cecil, Alberta and Loverna, Saskatchewan areas through the purchases of:

- (i) all the issued and outstanding shares of 567637 Alberta Ltd., a corporation formed for the purpose of making the acquisition. The purchase price of this corporation was \$9.5 million comprised of \$5 million cash and three million common shares of the Corporation with a deemed value of \$1.50 per share (see note 5). Of this purchase price \$9.3 million had no income tax basis as the structure of the transaction was on a tax free basis to the vendor;

- (ii) all the issued and outstanding shares of H.R.P. Holdings Ltd., a corporation which held royalty interests in the Cecil property. The purchase price of this corporation was \$199,000 comprised of \$100,000 cash and 66,000 common shares of the Corporation with a deemed value of \$1.50 per share (see note 5).

The aggregate purchase price of these acquisitions was reduced by \$231,211, representing the net oil and gas revenues less operating and capital expenditures accruing to the assets between the July 1, 1993 Effective Date and the September 16, 1993 Closing Date. The combined cost of the acquisitions was \$9,496,327, including \$28,538 in legal costs. This net purchase price has been allocated to petroleum and natural gas properties.

These acquisitions have been accounted for by the purchase method; accordingly, the results of operations since the date of acquisition are included in these financial statements.

3. PROPERTY AND EQUIPMENT:

December 31, 1994	Cost	Accumulated depletion and depreciation	Net book value
Petroleum and natural gas properties and equipment	\$ 16,602,469	\$ 10,264,792	\$ 6,337,677
Other	191,299	99,729	91,570
	<u>\$ 16,793,768</u>	<u>\$ 10,364,521</u>	<u>\$ 6,429,247</u>
December 31, 1993			
Petroleum and natural gas properties and equipment	\$ 16,632,665	\$ 7,990,000	\$ 8,642,665
Other	121,883	19,937	101,946
	<u>\$ 16,754,548</u>	<u>\$ 8,009,937</u>	<u>\$ 8,744,611</u>

For the year ended December 31, 1994 and seven months ended December 31, 1993, the Corporation did not capitalize any overhead costs nor were any significant costs with respect to unproven properties.

For the year ended December 31, 1994, \$0.8 million of additional depletion was recorded against the Corporation's petroleum and natural gas assets to reflect a reduction in the estimate of the net recoverable amount.

During 1993, the Corporation made an acquisition (see note 2) of petroleum and natural gas properties. The cost ceiling (based on year end prices calculated as described under the capital assets section of note 1(b)) of the petroleum and natural gas properties acquired was less than the capitalized cost of those assets by approximately \$5.0 million. This deficiency resulted, in part, from a decrease in the price of oil at year end and the purchase of probable reserves and undeveloped lands. A \$2.0 million portion of the deficiency was not considered to be a permanent impairment of the ultimate recoverable amount. As such a \$3.0 million write down of petroleum and natural gas properties was made at December 31, 1993.

4. BANK DEBT:

	December 31, 1994	December 31, 1993
Revolving production loan	\$ —	\$ 500,000
Term loan	—	270,000
Other (note 5(e))	—	638,000
	—	1,408,000
Less current portion	—	908,000
	<u>\$ —</u>	<u>\$ 500,000</u>

The Corporation had no bank credit facility in place at December 31, 1994. A new revolving credit facility of \$500,000 was granted to the Corporation by a bank on March 15, 1995. The new facility bears interest at the bank's prime lending rate plus 1% and is secured by a fixed and floating charge debenture in the amount of \$2,000,000 on specific petroleum and natural gas properties.

5. SHARE CAPITAL:

(a) Authorized:

Unlimited common shares without nominal or par value

Unlimited preferred shares without nominal or par value

At the Corporation's Annual General Meeting, held on October 18, 1993, the shareholders approved a change in the Corporation's authorized common shares from 50,000,000 to unlimited; cancelled the authorized first preferred shares and second preferred shares, issuable in series, none of which were then issued and outstanding; and authorized an unlimited number of preferred shares, none of which are currently issued and outstanding. In addition, shareholders approved the reduction of the Corporation's May 31, 1993 deficit of \$7,014,917 through a reduction of the stated value of the issued and outstanding common share capital.

(b) Issued:

Details of common shares issued during the year ended December 31, 1994 and seven months ended December 31, 1993:

Common shares	Number of Shares	Amount
Balance, May 31, 1993	9,710,566	\$ 8,857,486
Issued to acquire 567637 Alberta Ltd. (note 2)	3,000,000	4,500,000
Issued to acquire H.R.P. Holdings Ltd. (note 2)	66,000	99,000
Issued for cash, on exercise of warrants	300,000	30,000
Issued for cash, on exercise of options	214,000	55,400
Issued to acquire property and equipment	35,000	35,000
Recovered from vendor referred to in note 5(e) and cancelled	(1,500,000)	(1,140,000)
Reduction from allocation of deficit against stated value of common share capital	—	(7,014,917)
Balance, December 31, 1993	11,825,566	5,421,969
Issued for cash, on exercise of options	194,000	29,400
Issued for cash, on exercise of warrants	700,000	70,000
Special warrants - converted (proceeds received in 1993)	4,000,000	6,366,788
Issued in settlement of lawsuit (note 5(d))	918,550	229,638
Balance, December 31, 1994	17,638,116	\$ 12,117,795

Special warrants	Number of Shares	Amount
Issued for cash	4,000,000	\$ 6,366,788
Net of issue costs of \$633,212	—	—
Balance, December 31, 1993	4,000,000	6,366,788
Converted into common shares	(4,000,000)	(6,366,788)
Balance, December 31, 1994	—	—

(c) Stock options:

At December 31, 1994, 895,000 common shares (December 31, 1993 - 769,000) were reserved for issuance upon the exercise of stock options granted to directors, officers, employees and others as follows:

Number of Shares	Exercise Price	Expiry Date
95,000	\$ 0.85	Sept. 7, 1995
150,000	\$ 0.50	Feb. 2, 1998
75,000	\$ 1.25	Dec. 3, 1998
475,000	\$ 0.70	April 13, 1999
100,000	\$ 0.70	May 16, 1999

(d) Settlement of legal claim:

On November 16, 1994 a settlement was reached in respect of a claim filed against the Corporation by the Agent and each purchaser of the 4,000,000 Special Warrants issued on September 16, 1993 (collectively, the "Plaintiffs"). As part of the settlement, an additional 918,550 common shares were

issued on March 16, 1995 to the Plaintiffs and the terms of the existing 2,000,000 Regular Warrants were changed. Each Regular Warrant now entitles the holder to purchase two common shares (previously one common share) at \$0.40 each (previously \$3.00 each) up to September 16, 1995 (previously September 16, 1994).

The additional 918,550 common shares were issued at an assigned value of \$0.25 per share totalling \$229,638, being the fair value of the shares as determined by the directors. This has been included within settlement costs in the income statement.

(e) Common shares recovered for cancellation:

The terms of an acquisition on March 1, 1993 entitled the Corporation to recover 1,500,000 shares issued as consideration. Such entitlement occurred when certain values represented to the Corporation by the Vendor of the private corporation at the time of sale did not materialize. The number of shares recovered was based upon deficiencies claimed by the Corporation with a final settlement agreed to with the Vendor on December 21, 1993. The shares were surrendered to the treasury for cancellation subsequent to the year end.

Pursuant to the settlement the Corporation also:

- (i) assumed \$638,000 in current bank debt;
- (ii) recognized a reduction in property and equipment of \$304,000;
- (iii) recognized a net gain on the settlement of \$558,000; and
- (iv) recognized the cancellation of the common shares recovered resulting in: a reduction of share capital of \$1,140,000; the elimination of contributed surplus of \$14,682 and a loss of \$345,318.

(f) Second Warrants:

At December 31, 1994, 1,000,000 Second Warrants were outstanding entitling the holder of each Second Warrant to purchase one common share of the Corporation at \$1.645 per share exercisable on or before February 2, 1996.

6. RELATED PARTY TRANSACTIONS:

During the year ended December 31, 1994, the Corporation paid \$22,000 (seven months ended December 31, 1993 - \$17,286) as rent to a corporation controlled by an officer of the Corporation who is also a director. The Corporation also paid legal fees and expenses of \$75,000 (seven months ended December 31, 1993 - \$153,000) during this period to a firm in which one of the directors is a partner.

7. INCOME TAXES:

Income tax expense differs from the amount that would be computed by applying the federal and provincial statutory rates of 44.3% to income before income taxes. The reasons for the differences are as follows:

	Year ended, December 31, 1994	Seven months ended December 31, 1993
Computed "expected" income tax expense (recovery)	\$ (780,000)	\$ (1,518,000)
Increase (decrease) resulting from:		
Non-deductible crown charges	220,000	48,000
Provincial rebates	(29,000)	—
Non-deductible depletion	842,000	1,355,000
Unrecorded benefit of current year's losses	—	115,000
Resource allowance	(167,000)	—
Utilization of unrecorded benefit of prior years' losses	(188,000)	—
Other	102,000	—
Actual income tax expense	\$ —	\$ —

The Corporation has non-capital losses and resource pools carryforward of approximately \$460,000 and \$3,900,000, respectively, the tax benefits of which are not recognized in the financial statements, except in conjunction with tax shelter deductions applied in full cost ceiling test calculations. The non-capital losses carryforward expire commencing in 1998.

At December 31, 1994, the Corporation has approximately \$4,000,000 (1993 - \$6,000,000) of petroleum and natural gas properties which have no income tax basis as a result of acquisitions without tax basis.

OFFICERS, DIRECTORS AND MANAGEMENT

Michael E. Lobsinger, B.A., B. Comm.
Chairman and Chief Executive Officer

Alan D. Jack, B.Sc., P.Eng.
Chief Operating Officer

James B. Howe, H.B.A., C.A.
Director

Thomas D. Wood, B.A., Economics
Director

Michael J. Perkins, B.A., L.L.B.
Director, Secretary and Legal Counsel

SOLICITOR

Ogilvie and Company
Calgary, Alberta

STOCK EXCHANGE LISTING

The Alberta Stock Exchange
Symbol "SRP"

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BANKERS

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Calgary, Alberta

REGISTRAR AND TRANSFER AGENT

Montreal Trust
411-8th Ave. S.W.
Calgary, Alberta T2P 1E7

WHOLLY OWNED SUBSIDIARIES

Spirit Energy Corp.
554742 Alberta Ltd.
Leduc East Petroleums Inc.
Spirit Waste Management Inc.

Produced by Canada Corporate Communications Inc.

